ECONOMIC ANALYSIS

SELIC is left unchanged at 11%; the tightening cycle is over (for now)

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After having gradually increased the SELIC rate by 375bp since April 2013, the Monetary Policy Committee (COPOM) decided to leave it at 11.0%, as we and most analysts foresaw. The accompanying statement signaled that a new dose of monetary tightening could be introduced not very far ahead, in line with our view that the SELIC will start to be adjusted upwards again no later than at the beginning of 2015.

The pause was expected, but the communiqué was somewhat surprising

The communiqué of the decision to leave policy interest rates at 11.0% was as follows: "Considering the evolution of the macroeconomic scenario and the outlook for inflation, the COPOM decided unanimously, at this moment, to maintain the SELIC rate at 11%, with no bias". The main surprise was the introduction of the expression “at this moment”. In other recent statements (January and March of 2014) that expression was used to signal a forthcoming change in the pace of the monetary adjustment process, as a sign of no commitment to taking the same exact decision in the following meeting. Therefore, we take the introduction of “at this moment” in the communique, as an open door for the COPOM to increase the SELIC further anytime soon, if the inflation outlook requires so.

We forecast an unchanged SELIC during 2014 and additional adjustments to take it to 12.25% in 2015

The magnitude of the monetary tightening cycle that started in April 2013, when the SELIC was at 7.25%, and lasted until April 2014, when the SELIC reached 11.0%, is similar or even larger than in the magnitude of the previous tightening cycles (375bp from Sep/04 to May/05; 250bp from Apr/08 to Sep/08; 375 Apr/10 to Jul/11). However, differently from the past, this time analysts expect inflation to not decelerate sharply ahead: inflation is currently at 6.3% YoY and expectations for inflation 12-months ahead are at 6.0% YoY, according to the consensus. At the end of the last three tightening cycles the difference between observed and expected inflation was much higher (between 1.0p.p and 3.0pp), showing that markets were then more confident on the impact of monetary policy on inflation than now (see our 2Q14 Brazil Economic Outlook, p.12-13 for more details) . Resilient expectations, pressures coming especially from administered-price inflation and the impact of the depreciation of exchange rate on tradable prices (in spite of the recent appreciation, which we see as temporary), and the gradual normalization of monetary conditions in the US should force the COPOM to hike the SELIC again not very far ahead. In our view, the most likely scenario is one with an unchanged SELIC at 11.0% during 2014 and a new round of adjustments taking it to 12.25 at the beginning of 2015. However, yesterday's communique suggests that this additional adjustment could be adopted earlier than we expect.